

Message Text

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PAGE 01 SEOUL 02956 100920 Z

16

ACTION EB-11

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TAGS: EFIN, KS

SUBJECT: KOREA WILL EXCEED IMF CREDIT CEILING

REF: A. SEOUL 784 B. CERP

SUMMARY: MID- YEAR IMF STANDBY CEILING ON DOMESTIC CREDIT WAS NEARLY ATTAINED ON APRIL 30. ROKG NOW FORECASTS 14.7 PERCENT CREDIT INCREASE FOR FIRST HALF, COMPARED 11.9 PERCENT PERMITTED, BUT STILL HOPES TO KEEP WITHIN FULL YEAR LIMIT OF 23.9 PERCENT. IMF REACTION UNKNOWN BUT LIKELY TO BE TOLERANT. GROWING BUSINESS AND INVESTMENT BOOM WILL POSE CRUCIAL CHOICES BETWEEN STABILIZATION AND EXPANSION IN COMING MONTHS. END SUMMARY.

1. PRELIMINARY MONETARY DATA FOR APRIL INDICATES MID- YEAR CEILING FOR DOMESTIC CREDIT UNDER IMF STANDBY AGREEMENT WILL CLEARLY BE EXCEEDED. ALL BUT ABOUT 2 BILLION WON OF FIRST HALF CREDIT INCREASE OF 182 PERMITTED BY STANDBY WAS USED IN FIRST FOUR MONTHS. CREDIT TO GOVERNMENT ROSE 63 BILLION WON OUT OF TOTAL INCREASE OF 68 STIPULATED FOR JUNE 30. (ROKG EASILY MET ONLY FIRST QUARTER CREDIT CEILING IN STANDBY WHEN CREDIT TO LIMITED OFFICIAL USE

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PAGE 02 SEOUL 02956 100920 Z

GOVERNMENT ROSE ONLY 48 OUT OF 78 BILLION WON INCREASE PERMITTED) ON MARCH 31. CREDITS TO PRIVATE AND FERTILIZER SECTORS THROUGH APRIL ROSE BY 113 AND 4 BILLION WON RESPECTIVELY, SLIGHTLY EXCEEDING TOTAL PERMITTED FIRST HALF INCREASE OF 114 BILLION WON. TOTAL DOMESTIC CREDIT INCREASE OF 11.8 PERCENT IN FIRST FOUR MONTHS, OUT OF 23.9 PERCENT INCREASE AGREED FOR ENTIRE YEAR, IS ATTRIBUTED TO RAPIDLY DEVELOPING BUSINESS BOOM (BEING REPORTED SEPARATELY) AND EXPECTED FIRST HALF DEFICITS IN BUDGET AND GRAIN MANAGEMENT FUND.

2. MONEY SUPPLY CONTINUED TO EXPAND RAPIDLY IN FIRST FOUR MONTHS, RISING 15 PERCENT DUE MAINLY TO GOVERNMENTAL DEFICITS AND \$68 MILLION INCREASE IN FOREIGN EXCHANGE HOLDINGS. TIME AND SAVINGS DEPOSITS ROSE BY 11 PERCENT, OR FASTER THAN TARGET RATE. CURB MARKET FOR BUSINESS LOANS REPORTEDLY REMAINS RELATIVELY MINOR, DUE TO CHANGES IN TAX INCENTIVES AND FEAR OF FURTHER GOVERNMENT ACTION. PRESS RECENTLY REPORTED INCREASED DEMAND FOR CURB LOANS, COMBINED WITH THIN SUPPLY, HAD RESULTED IN LENDING RATE INCREASE FROM 3 TO 4 PERCENT PER MONTH.

3. GOVERNMENT REACTION TO CREDIT INCREASES HAS BEEN TO REDUCE CENTRAL BANK CREDIT TO COMMERCIAL BANKS, TO RAISE RESERVE REQUIREMENTS BY 3-4 PERCENT EFFECTIVE MAY 16 AND TO REINTERPRET MID- YEAR CREDIT CEILINGS, WHICH HOLDING TO YEAR- END TARGET AGREED WITH IMF. " REINTERPRETATION" HAS NOT BEEN MADE PUBLIC AND IS JUST NOW BEING COMMUNICATED TO WASHINGTON BY IMF RES REP. FINANCE OFFICIALS STATE THEY ARE NOW TRYING TO LIMIT FURTHER CREDIT INCREASES TO PRIVATE SECTOR TO 2.0 PERCENT PER MONTH AVERAGE RATE ACTUALLY ACHIEVED IN FIRST FOUR MONTHS. (STANDBY STIPULATES ONLY 8.0 PERCENT FIRST HALF INCREASE. DUE TO LARGE SEASONAL GOVERNMENTAL CREDITS ENVISAGED, BUT PERMITS 22.8 PERCENT INCREASE FOR YEAR AS A WHOLE.) CREDIT TO GOVERNMENT SECTOR IN FIRST HALF WILL BE KEPT WITHIN 68 BILLION WON INCREASE PERMITTED; CURRENTLY A NET INCREASE OF 50 BILLION WON IS ESTIMATED, INCLUDING A 60 BILLION WON INCREASE BY GRAIN MANAGEMENT FUND. FERTILIZER CREDITS ARE EXPECTED TO INCREASE BY 7 BILLION WON.

4. TOTAL FIRST HALF CREDIT INCREASE IS THUS ESTIMATED AT 223 BILLION WON OR 14.7 PERCENT, COMPARED TO 182 BILLION WON AND 11.9 PERCENT INCREASE STIPULATED IN STANDBY. SECOND HALF INCREASE WOULD HAVE TO BE LIMITED TO 141 BILLION WON, COMPARED TO 182 LIMITED OFFICIAL USE

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PAGE 03 SEOUL 02956 100920 Z

STIPULATED. FINANCE OFFICIALS FEEL THIS MAY BE FEASIBLE IF PRIVATE CREDITS CAN BE LIMITED TO 2.0 PERCENT MONTHLY INCREASE AND GOVERNMENTAL CREDITS CAN BE HELD BELOW 40 BILLION WON INCREASE STIPULATED FOR ENTIRE YEAR. HOPE FOR LATTER RESTS ON HIGHER- THAN- EXPECTED GOVERNMENT REVENUES AND PROBABLE LOWER- THAN- FORECAST FALL RICE PURCHASES BY GMF, DUE TO LOWER FIRST HALF RICE SALES AND LARGER CARRYOVER OF STOCKS.

5. IMF RES REP (WHO DOES NOT WISH TO BE QUOTED) BELIEVES FUND MAY TAKE TOLERANT VIEW OF REVISED GOVERNMENTAL TARGETS FOR FIRST HALF SO LONG AS COMMITMENT TO FULL YEAR TARGETS MAINTAINED. STANDBY CONSULTATIONS CALLED FOR IN CASE OF DEVIATIONS FROM CEILINGS WOULD PROBABLY BE HANDLED BY CORRESPONDENCE, SINCE NO VISITING MISSION IS CURRENTLY PLANNED UNTIL NEXT JANUARY. IMF ASIA DIRECTOR TUN THIN HELD GENERAL DISCUSSION WITH MINISTER NAM AT APRIL ADB MEETING AND SITUATION CAN BE REVIEWED AGAIN IN SEPTEMBER AT ANNUAL FUND MEETING.

6. COMMENT: KOREAN FAILURE TO MEET MID- YEAR CREDIT CEILING REFLECTS BOTH (1) PRIVATE CREDIT NEEDS GENERATED BY CURRENT BUSINESS BOOM AND (2) PECULIAR STRUCTURE OF STANDBY CEILING WHICH LIMITED FIRST HALF PRIVATE CREDIT INCREASE TO 8 PERCENT, WHILE PERMITTING SECOND HALF INCREASE OF ABOUT 14 PERCENT. REVISED GOVERNMENT FORMULA APPEARS MORE SENSIBLE. REAL TEST OF GOVERNMENT POLICY TOWARD STRONG BUSINESS DEMAND FOR INVESTMENT CREDITS SHOULD COME IN NEXT FEW MONTHS WHEN BANK CREDIT SHOULD BE VERY TIGHT, FOREIGN BANKING CREDITS OF \$180 MILLION FOR ENTIRE YEAR WILL HAVE BEEN FULLY COMMITTED AND FOREIGN COMMERCIAL BORROWING MAY BEGIN TO BE LIMITED BY IMF CEILINGS ON NEW DEBT. GOVERNMENT WILL BE RELUCTANT TO RAISE INTEREST RATES SINCE IT IS PUBLICLY COMMITTED TO LOWER RATES BASED ON REDUCED RATE OF INFLATION. AT SUCH TIMES IN PAST CURB MONEY MARKET HAS EXPANDED TO MEET BUSINESS NEEDS. GOVERNMENT THUS FACES DIFFICULT SERIES OF CHOICES BETWEEN EXPANSION AND STABILIZATION IN COMING MONTHS, WHICH MAY SET PATTERN FOR NEXT SEVERAL YEARS.
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